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SUBJECT: Foreign Investment Flows into Ecuador: 2007 Better than a Bad 2006

Ref. A) Quito 192, B) 07 Quito 2277

¶1. (SBU) Summary. Foreign direct investment in Ecuador totaled $471 million in the first nine months of 2007. This reflects a rebound from 2006, when the net investment flows were reduced by the departure of U.S. and Canadian oil companies. As a result, investment in petroleum and from the U.S. and Canada showed an improvement in 2007. Foreign investment declined in most other sectors in 2007, and investment from a number of other important sources (Brazil, Mexico, Europe) also declined in 2007. End summary.

¶2. (SBU) According to Ecuadorian Central Bank (BCE) data, foreign direct investment for the first three quarters of 2007 ($470.8 million) was higher than the same period in 2006 ($124.2 million). The 2007 data appear to reflect a modest recovery from a particularly poor performance in 2006, when the assets of Occidental Petroleum were seized and Canadian petroleum company Encana sold its assets to a Chinese company. These developments show up as net outflows in 2006 for the petroleum sector and for U.S. and Canadian investment. In contrast, the petroleum sector showed net inflows in 2007, as did investment from the U.S. and Canada.

¶3. (SBU) Leaving aside the experience of U.S., Canadian and petroleum investment, the data for 2007 show a mixed but generally declining trend for FDI in 2007. Investment from Brazil, Mexico, and Europe dropped in 2007, although that from China increased from a very low level in 2006. Investment in the manufacturing, commerce and transport/communications sectors also dropped in 2007, although investment in services did increase. Furthermore, FDI in 2007 was lower than it was from 2002-04, when annual FDI averaged $830 million.

¶4. (U) The following tables show FDI data for selected countries and sectors. Data are for the first nine months of each year. Totals include all FDI and therefore exceed investment for the countries and sectors shown.

FDI flows by country/region
U.S. dollars, millions
January-September

Year	2006	2007
U.S.	-124.1	67.5
Brazil	244.3	141.0
Canada	-253.0	23.4
Mexico	42.6	-40.2
Europe	62.0	42.1
China	2.9	50.4
Total	124.2	470.8

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FDI flows by sectors

U.S. dollars, millions
January-September

Year	2006	2007
Petroleum/mining	-236.6	282.2
Manufacturing	46.6	30.8
Commerce	84.4	70.4
Services	53.7	70.0
Transport/communications	94.9	-16.0
Total	124.2	470.8

Source for 2007 Investment

¶5. (U) We understand that the European and Chinese oil companies continued to invest, although at reduced rates, for the first three quarters of 2007. Only after the Correa administration increased the windfall oil income tax to 99% (reftel b) in October did the companies freeze their investment plans (that impact would appear in fourth quarter data which we have not yet seen).

¶6. (SBU) One major investment project, construction of the new Quito airport, continues to move forward. According to the airport consortium, Quiport, the investors disbursed $44 million in 2007, much of which came from the U.S., with the balance from Canada and Brazil. We also understand that some U.S. companies, particularly those outside the more contentious regulated sectors, continued with their investment plans in 2007. For example, Pfizer opened a new $50 million facility. Others told us that they were making investments to address bottlenecks or introduce labor-saving equipment out of concern that labor costs could rise.

¶7. (U) Brazilian companies are currently the largest investors in

Ecuador. In addition to Petrobras, the large Brazilian construction firms Odebrecht and Andrade Gutierrez are active in Ecuador. Andrade Gutierrez is a partner in Quiport, and the two companies are some of the most important contractors for major government infrastructure projects.

¶8. (SBU) One economic analyst speculated that reduced lending to Ecuador, following the Correa Administration's statements in early 2007 that it might default on some loans, led to increased FDI. He argued that companies which previously relied on loans had to replace some of those loans with capital. While we have not seen much evidence to reinforce this theory, it seems plausible. One U.S. oil company still operating in Ecuador lost its bank loan. In addition, many Ecuadorian companies have kept their capital offshore, relying instead on tax deductible international loans. It is possible that some of them also lost their loans and were forced to bring back some their capital, which may have been reported as foreign investment.

Comment

¶9. (SBU) In general, 2007 was considered a difficult year for investment, as the Correa administration spooked investors with its often harsh economic rhetoric, even though in practice most of its policies were more practical than its rhetoric (reftel a). Therefore it was a surprise to see that foreign direct investment picked up in 2007. Some of that was due to a rebound from an even more difficult 2006, but after separating that out it appears that FDI continued last year, albeit at a reduced rate.

¶10. (SBU) Much of last year's investment was already in the pipeline going into 2007. Now most private investment in the important petroleum sector is frozen and the investment climate will remain uncertain until the government renegotiates contracts with the major oil investors. After that, even if the new contractual structure is agreeable to the oil companies, it will take time for them to restore their investment programs. We suspect we may see a similar picture in other sectors as well, since some companies have told us that they were completing planned investment but were placing new investment plans on hold until the investment environment became more predictable.